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METHODS AND POTENTIALITIES OF BREAK-EVEN ANALYSIS

by

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PARTS I AND II

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INTRODUCTION

This paper examines critically the more common forms of break-even analysis and considers the problems raised in making break-even charts more useful to management. The paper has two purposes: first to promote more refined methods of analysis, and, second, to develop a more sophisticated interpretation. The paper is not intended to be an exhaustive treatment of the subject, but is offered rather as a contribution from across the seas to the lively and penetrating discussion of "break-even" problems that presently engages Australian accountants at all levels.

The first section is a brief description of the nature of break-even analysis. The second section describes alternative methods of attack in the determination of the empirical cost function: it considers the practical problems of adjusting historical data to present conditions, measuring rates of activity, and purging the data of extraneous influences.

The third section examines the limitations of conventional break-even charts and appraises their ability to forecast profits in a dynamic economy. The concluding section discusses the kinds of managerial problems and the areas where break-even analysis may have legitimate value and suggests ways in which the device can be adapted to those problems.

It must not be thought that the problem of overcoming the deficiencies of static break-even analysis—in order that it be developed as a more useful forecasting and management tool—has been completely resolved. There is still much to be done.

One of the most important things to do is to set up the empirical cost analysis so

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that it is susceptible to projection in a dynamic way. This must be regarded as a pre-requisite to a good job of cost forecasting. In many firms the product-mix also needs to be forecast, since it has a profound effect upon the break-even "point." Estimates of the way in which the firm's selling prices will change with business activity and also the way the firm's cost-prices will change then should be developed, although, in our country at least, the relationship of a firm's volume to its cost prices is not likely to be very close.

The break-even chart has now achieved such world-wide acceptance as a management tool that in some quarters there has been an unfortunate over-emphasis of its usefulness. In a variety of forms it is injected into the analysis of pricing, product policy, and investment decisions, but break-even analysis, with all of its flexibility, does not warrant an unquestioning acceptance. It must be applied with an intelligent discrimination, with an adequate grasp of the assumptions underlying the technique and of the limitations surrounding its practical application.

I.—NATURE OF BREAK-EVEN ANALYSIS

A break-even chart is a diagram of the short-run relationship of total cost and of total revenue to rate of output. These relationships should be conceived of as static. The total cost function is drawn on the assumption of constant wage rates, material prices, plant scale and depth, technology, and efficiency. The total revenue function assumes selling prices, product-mix, and distribution-mix unchanged.

The spread between the sales line and the total cost line defines the profit function, which is the empirical counterpart of the short-run relationship between profits and output rate, with traditional constancies. It thus portrays a family of conjectural income statements for various outputs. The analysis is, hence, broader than is indicated by the name "break-even chart," which places unfortunate emphasis on the zero-profit member of the family.

The concept of break-even analysis should be broadened to include not only the chart, for it is merely a presentation device, but the analysis of cost relationships which underlie it, and the raw material behind these analyses. Under this conception, its usefulness is widened. Much of the constituent raw material is useable for modification and adjustment of static charts and for other purposes than profit projection (i.e. flexible budgets and expense control). The practical application of the data should not be tied to the chart presentation device. Tabular presentation is sometimes a more flexible way of comparing the cost and profit results of alternative plans. Moreover, the constituent functional relationships can sometimes be more compactly summarized as equations and more flexibly manipulated as such.

Break-even analysis (which will refer not only to the presentation device, but also to the basic relationships themselves and the methods generally used to determine them) produces flexible projections of the impact of output rate upon expenses, receipts, and profits, assuming other things equal. If determination of this profit-output relationship will produce reasonably accurate predictions, then break-even analysis has considerable significance for company management.

Most break-even analyses are based on the concept of static cost and revenue functions, but they differ in attainment of this ideal. At one extreme are charts based on an all-out attempt to remove dynamic influences. In statistical studies this is done by rigorous sampling, deflation, lag corrections, multiple correlation, and other statistical refinements.

At the other extreme stands the "migration-path" break-even chart, which is developed from annual data that cover a long period of years, with no correction for the substantial changes that have occurred in dynamic factors such as prices, efficiency, technology, and plant. Output is measured by sales volume in current dollars, rather than by an index of physical production. A sort of dynamic total cost function, which appears to be linear and which often shows only moderate scatter, has been obtained for many enterprises. Sometimes sub-groups of consecutive years show different lines of fit. The result is not a static total cost function, but a movement-path

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on a series of shifted static functions. A sort of dynamic profit function can also be determined directly by correlation of historical profits and output, with constancies abandoned. Scatter diagrams of this sort are used in investment analysis.

Flexible Budgets and Break-even Charts

Break-even analysis should be distinguished from flexible budgets. The variable expense budget is built on the same basic cost-output relationships, but it is confined to costs and is primarily concerned with the components of combined cost, since the purpose is to control cost by developing expense standards that are flexibly adjusted to activity rate. This purpose often leads to measures of activity that differ among costs and operations, so that they cannot be readily added or translated into an index of output for the enterprise as a whole.

A flexible budget differs from a break-even chart in several important respects:—

(1) The purpose of the flexible budget is to control cost, whereas the central purpose of the break-even chart is to predict profit.

(2) The flexible budget is a device for refining the static standard or budget figure by adjusting for variation of the output rate. Consequently, it must be closely conformed to areas of executive responsibility if it is to be most useful for expense control. This may mean that the territory encompassed by a given cost function will be determined basically by the structure of executive responsibility.

(3) As a result, the analysis of the relation of cost to output for flexible budget purposes will be more detailed than is necessary for the break-even chart. It may also be based upon a different measure of activity for different responsibility areas. If this is necessary, then the relationships between cost components and activity rates may not be readily added, with the result that some adjustments must be made to get break-even chart cost curves from them.

But since flexible budgets are based on the same kind of analysis of relations of cost to output (or input), they are also discussed in this article. They are a part of break-even analysis broadly conceived.

The major classes of executive uses of the break-even analysis are:—

(1) Prediction of the probable level of profits at various levels of output (this includes prediction of the output rate to break even or to make a designated contribution to company or departmental overhead and profits).

(2) Planning and control of profits and control of expense.

(3) Prevision of expense and revenue estimates and comparisons that help answer various management problems.

II.—PROBLEMS OF CONSTRUCTING BREAK-EVEN CHARTS

Different Approaches to Determination of Cost Behaviour

Determination of cost behaviour is always the major problem in break-even analysis. Several different approaches to this problem are possible:—

(1) Classification of accounts into fixed, variable, semi-variable, on the basis of judgment and inspection.

(2) Determination of the cost function and the degree of output variation by statistical analysis.

(3) Estimation of the relationships of cost-output on the basis of engineering conjectures.

The method of statistical analysis of past behaviour of costs is the most thorough and "scientific," hence it deals with each major problem of determining empirical cost relationships explicitly. The other two methods must cope with each of these problems, but they do so less consciously and usually less successfully. Hence, this article will begin with and will emphasize the statistical approach since this will assure that each method's problem will be more fully understood.

How to Decide Which Approach is Best

These three approaches—statistical, accounting, and engineering—are not always

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mutually exclusive. Often it is desirable to use two or more to supplement each other. Nevertheless, it is usually desirable to try to determine at the outset which of the three should receive greatest emphasis.

STATISTICAL APPROACH.—The statistical approach, when conditions are appropriate for its use, is likely to produce more reliable results than the other methods. However, it is more time-consuming and expensive if applied in a thorough manner.

For the statistical method to be feasible, certain conditions must be met:—

(1) Detailed records of costs and of output must be available over a long enough period to produce enough observations to make the statistical relationships reliable. Typically, this means three or four years when monthly observation units are appropriate.
(2) Output (i.e. activity rate) must have fluctuated over a wide range with a fairly even coverage reported in the observation.
(3) Plant size, technology, and labour efficiency must have stayed relatively constant during the analysis period so that the effect of output rate on cost can be determined without too much distortion in changes of these other factors.
(4) Data must be available for adjusting the cost records for the effects of changes in wage rates, material prices, and any other important measurable extraneous factors during the analysis period.
(5) The design and method of construction of the product should be fairly stable over the analysis period.

These are the requisites for a fully successful statistical analysis of cost behaviour. They do not all need to be met to make the use of statistical techniques helpful in determining cost behaviour.

ACCOUNTING APPROACH.—The accounting approach involves classification of expenses as: (1) fixed, (2) variable, and (3) semi-variable, on the basis of inspection and experience. This approach is the simplest and least expensive of the three. Hence, it should normally be used whenever feasible as a supplement to the other methods if not the principal method. To be most successful the requisite conditions are:—

(1) Experience with a wide range of fluctuation in output rate.
(2) A detailed break-down of accounts kept on the same basis over a period of years.
(3) Relative constancy in wage rates, material prices, plant size, technology, etc.

Since the accounting approach provides no way of explicitly correcting data for changes in cost prices or for changes in other conditions that affect cost behaviour, a constancy of these cost conditions is essential if accurate results are to be obtained this way. The statistical method can tolerate more variation in underlying conditions because it possesses a means of dealing with these variations. Uniform coverage of the output range is not essential for success of the accounting method. A group of observations at each extreme of the range is sufficient. The accounting method isolates constant cost by inspection with ease. It classifies variable cost easily, but determines less accurately the pattern of variation of these and of semi-variable costs. The accounting approach needs to be supplemented by graphic statistical analysis to separate out the variable and fixed components of semi-variable cost and to determine the pattern of relationship for semi-variable and for variable costs.

ENGINEERING APPROACH.—The engineering approach is the only feasible method when the inadequacy of experience and records provides little systematic historical basis for estimating cost behaviour. The approach is also a desirable supplement to statistical or accounting analysis when it is desired to project cost behaviour beyond the range of past output experience or when it is necessary to estimate the effect of major changes of technology or plant size upon cost behaviour over a familiar or unfamiliar output range.

In essence, the engineering method consists of systematic conjectures about what cost behaviour ought to be in the future on the basis of what is known about the rated capacity of equipment modified by experience with manpower requisites and efficiency factors and with past cost behaviour. Hence, it depends upon knowledge of physical relationships supplemented by pooled judgments of practical operators. It should, and usually does, make use of whatever analyses of historical cost be-

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haviour are appropriate and are available as a means of making the judgment better. Typically, the engineering estimate is built up in terms of physical units, i.e. man-hours, pounds of material, etc., and converted into dollars at current or prospective cost prices. The cost estimates are usually developed at a series of peg points that cover the contemplated or potential output range.

How to Pick the Analysis Period

For the statistical or accounting approach, it is necessary to select a period of years for study. The criteria that have proved useful in making this selection are:—

(1) The period should be the most recent one that will provide necessary stability of cost conditions and range of output fluctuations.
(2) Accounting records should be comparable throughout the analysis period.
(3) There should be sufficient independent fluctuations in demand, and hence in output, to get a wide range of observations of both cost and output.
(4) A sufficient number of observation units (usually months) should be included to permit valid statistical analysis.

What Kinds of Adjustments Must be Made in the Data?

To make a thorough statistical analysis, various kinds of rectifications of the raw data are essential. An all-out attempt to remove sources of distortion of the cost-output relationship is expensive and time-consuming. For many practical purposes, the improved accuracy does not justify the added expense. Hence, short cuts that use the same basic statistical method but bypass some of its refinements are usually desirable in developing break-even analysis. However, it is dangerous to take short cuts without knowing where you are going. Hence, an understanding of the rectification steps that are being simplified or eliminated is essential for sound short cuts. This article will therefore outline these correction problems.

Major Rectification Problems.—Some of the principal problems of direct rectification of the data are:—

(1) Selection of the costs to be included in the analysis.
(2) Determination of the basis of valuation.
(3) A correction for changes in wage rates and other cost-prices, so that the adjusted observations will be comparable.
(4) Adjustment for differences in the length of months (e.g. 5-week vs. 4-week record periods).
(5) Adjustment for the time lag between the recording of costs and of the output to which the costs contributed.
(6) Adjustment for special and non-recurring items.

Selection of Costs.—Selection of the costs that should be included in the break-even analysis should be governed by its purpose, i.e. by the practical managerial use to which the analysis is to be put. Different purposes demand different cost concepts and different break-even charts. Greatest flexibility in modifying the chart to fit the purpose will be obtained if cost components are analyzed separately so that they can be recombined as the purpose and concepts demand. One use of break-even analysis is for managerial control, e.g. profits or contribution control or determination of flexible expense standards. For this purpose, the criterion of inclusion of cost should be whether or not the executive in question has spending authority over the cost. To be most successful in fulfilling this managerial purpose, separate break-even analyses should be made for each managerial unit and only those expenses which are controllable at that executive level should be included. If a revenue function is introduced, then the profit becomes a contribution profit which is different from a net profit and which is presumably controllable at that level.

Certain categories of cost which raise particular problems of inclusion should be briefly considered. Selling expenses present an intricate problem because there is no logical functional relationship between promotional expenditure and production rate. To be sure, some kinds of selling costs may be functionally related to sales rate, e.g. salesmen's commissions. Others may be synthetically related to sales because of some mechanistic method of determining

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advertising cost, e.g. X per cent of actual or budgeted sales. But to treat selling costs as therefore variable with factory activity rate is a mistake. Instead, it is usually desirable to build the break-even chart on the basis of some carefully specified assumption as to the expected level of future selling cost outlay. Logically, there should be then a different break-even chart for each assumed level or policy.

Design expenses also present a special problem. In some industries or departments they constitute an important part of cost. One way out is to split design expenses into two parts: (a) sunk costs which should be treated as constant regardless of short-run fluctuations in output rate, and (b) running costs which include follow-through costs associated with actual operations. These costs may bear little relation to short-run changes in output rate, and are likely to decline as a function of skill and familiarity. They constitute a sort of shrinking fixed cost.

Assessed costs present another kind of problem. These include general overhead of the company or of the department that are allocated to divisions or plants on a basis that is necessarily somewhat arbitrary. For some assessed items, the amount of the allocation (1) depends upon the activity rate of the department as a whole, which affects the total of this cost and also (2) depends upon the activity rate of the plant or division, which affects its share of the cost. For many purposes such costs should be excluded from the break-even analysis. When they are relevant they should probably be treated as constant costs with carefully specified assumptions as to their level and with provisions for changing this level when circumstances warrant it.

Basis of Valuation.—The problem of the basis of valuation of costs is usually not faced explicitly in break-even analysis. This is because the valuations and conventions of accounting underlie break-even analysis and are tacitly accepted. However, *for some managerial purposes, it is desirable to go behind accounting analysis and raise questions about the valuation foundation. This is particularly true during a period of structural change in the price level such as we are now living through. Depreciation charges, for example, are based upon original cost. This valuation basis is for some purposes unrealistic when current replacement costs are seriously different from the price level of acquisition.*[1] Inventory costs usually reflect cost or market whichever is lower. But in periods of inflation this produces distortion of the profit statement. Since many practical uses of break-even analysis stretch into the future, it is sometimes desirable to develop special break-even analyses based on projections of future price levels.

Correction for Past Changes in Cost-Prices.—Whenever the break-even chart is based on cost behaviour, the problem of adjusting the cost observations for changes in wage rates and material prices is likely to arise. A crude way of bypassing this problem is to put both the measure of activity (e.g. direct labour dollars) and the measurement of costs on a current dollar basis. This method assumes that the changes in the value of the dollar will have exactly the same proportionate effect on the activity index as upon each component of cost. Examination of typical price behaviour in the past gives little support to this theory.

Consequently, it is usually necessary to face up to the problem of rectification of price level changes. This can be done by putting all components of costs as well as the measure of activity on the basis of physical units. But this presents a problem of a common denominator when components of costs are combined. Another approach, and the one that is usually more successful, is to correct each component of cost for changes in prices that affect that component. This can be done quite simply by the construction of special purpose index numbers.

The purpose of this correction is, of course, to put all cost observations on a comparable basis measured in dollars of the same size (e.g. 1947 dollars). It is usually more convenient and realistic to make the bench-mark[2] a recent period and adjust the earlier observations to that level, but there is no statistical necessity for doing it that way.

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[1] The italics are ours.—Editor.

[2] Bench-mark—a point adopted for convenience, the level of which acts as a basis for the calculation of other levels in the vicinity of that point.

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Length of Month.—When, as is usually the case, the observation unit is a month, it is necessary to make an adjustment for the varying length of the calendar month or the record month, e.g. 5-week vs. 4-week record periods. This adjustment can be made quite simply and must be carried out for both the activity index and the costs.

Time-lag Adjustment.—To find the relationship between cost and output, it is necessary to synchronize costs with the output to which they contributed. The problem has not been accorded the recognition in break-even analysis that it deserves. Its importance depends on: (1) whether an output index or input index is used; (2) the length of the production cycle as compared with the length of the record period; and (3) the importance of the kind of expenditure (e.g. maintenance) where a wide latitude of timing exists.

Correction for time-lag errors is tedious and not entirely satisfactory in short-period analysis. The use of an input index of production (standard direct labour dollars) simplifies the problem and reduces the size of errors. Hence, for practical purposes it may be possible to bypass this problem when such an index is used.

Non-recurring Expenses. — Particularly during the early development stages, non-recurring expenses distort the cost records and make them an unreliable basis for projecting cost-output relationships. Learning-costs and mistakes-costs ought theoretically be sifted out in using past records. This is difficult to do, however, in practice. Every period in the development stage looks to the operators to be non-typical. Sometimes inspection of scatter diagrams coupled with familiarity with what happened in the month in question can result in exclusion of non-typical observations. However, this approach has its hazards, and may produce results that are highly subjective.

How to Measure Activity Rate

Perhaps the most difficult problem in construction of a break-even chart is to get a good index of activity rate for a multiple-product plant which has a variable product mix. In choosing among the several possible ways of measuring activity rate, the decision should be governed by certain general criteria:—

(1) Ability of the activity index to fit the ultimate practical uses of break-even analysis.
(2) The closeness of the relationship of the index to elements of cost.
(3) The imperviousness of the index to changes in prices, product-mix, and distribution channel-mix.
(4) Comparability through time (i.e. the index should be unaffected by price and wage rate changes).
(5) Universality of the index so that the same base can be used by all cost components in a given plant so that it will facilitate combination of plants and divisions to get a department-wide break-even chart.

A basic choice must be made between: (1) index of sales (usually in dollars, current or deflated) and (2) index of production. The use of sales rather than production to measure activity rate is widespread in break-even analysis, yet it is fully satisfactory only if selling is the dominant activity of the firm or if the production and sales rates are closely synchronized, which is rarely the case when demand fluctuates seasonally and production is stabilized. In these circumstances, the use of a sales index to measure activity rate introduces serious error, particularly if the analysis period is short. Normally, it is better to measure activity by production. This makes it necessary to bridge the gulf between non-synchronized sales and production activity. Bridging may take the form of adjustments for inventory or reconstruction of any expenses which are a function of sales or orders on the assumption that the output is sold in the period in which it is produced.

Output Indexes.—In developing an index of production, a choice must be made between: (1) output measured in dollars, either current or corrected for the price level (e.g. 1940 dollar); (2) output measured in a simple count of the number of units produced (e.g. tons of steel); (3) output measured by a production index which weights dissimilar products on the basis of standard production costs (e.g. weighted products expressed in terms of the equivalent of some standard product).

When the output is made up of large numbers and variety of products which differ clearly in contribution margins, out-

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put cannot be satisfactorily measured in dollars (current or deflated), or by a simple count of physical units. The only kind of output index that can hope for success is one which is weighted on the basis of standard production costs. For example, such an index for a gas heating-equipment plant would express output in terms of a standard furnace by converting each furnace type into standard units on the basis of the standard production cost of each furnace.

This sort of physical output index has several advantages over current dollar value measure of output: (1) it makes the production cost functions (x material costs) impervious to changes in the product-mix and the distribution channel-mix; (2) it makes it possible to build the break-even analysis on the foundation of investigations that underlie flexible budget determinations; (3) it produces cost functions which are unaffected by changes in selling prices and in discounts. Such changes can more simply be reflected by adjustments of the revenue function than by adjusting the cost function for this sort of intricate distortion.

The weights for a good output index should not vary with changes in wage rates or material prices, but should be constant. They should also reflect standard costs rather than actual costs. If this is done, the index will not be distorted by changes in efficiency or changes in cost-prices.

The weights for the index should, in some cases, be based on direct labour cost and should not include direct material cost. To be sure, direct material costs are more important than direct labour cost in, e.g., a gas heating-equipment plant, yet furnaces differ greatly in material costs, and other elements of cost are less highly correlated with material costs than with labour costs.

INPUT INDEXES.—An input index is a particularly appropriate measure of activity when products are numerous and differ greatly in standard costs and in margins. For some industries, an input index has two important advantages over an output index: (1) the problem of matching output and cost which is caused by production-cycle lags is less serious for input indexes than for output indexes; (2) the construction of an input index is simpler, and (3) if standard direct labour costs are used as the input index, it is more familiar to the production staff than an output index would be.

Input indexes can take several forms: (a) direct labour hours, standard or actual; (b) direct labour dollars, standard or actual; (c) direct material dollars, standard or actual; and (d) a combination of labour and material.

In choosing among these several forms of input indexes, a number of considerations are important. To illustrate, a study of conditions in a gas heating-equipment plant showed that:—

(1) Standard direct labour cost was a comparatively small proportion of total cost. For all furnaces, standard direct material cost averaged more than six times direct labour cost. Hence, omitting direct material cost would leave out a very important element of cost.

(2) The relative importance of material cost and labour cost differed considerably among furnace models. This ratio varied almost 100% from its low to its high. However, a group of furnaces where the highest ratio of material to labour was 127% of the lowest ratio accounted for approximately 90% of the volume. This is because large steam and hot water furnaces which had highest material cost were not produced in large numbers.

(3) A rough scatter diagram test indicated that a combined labour and material input index bore no close relationship to variable indirect manufacturing expense.

(4) Standard direct labour costs, on the other hand, showed a close relationship to most other cost components. And this relationship had been worked out as a means of obtaining the variable indirect manufacturing expense benefit for many operations.

(5) The disparity among furnace types in the amount of direct materials means that direct material cost is highly dependent upon the product-mix. Hence, the material cost component is not determinable until the product-mix has been specified. As a consequence, it is simpler to add the estimated direct material cost of

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a specified product-mix to a cost function which is impervious to product-mix.

(6) For combining cost functions for gas heating-equipment with those of oil heating-equipment and for combining divisions to get a department-wide break-even chart, an activity index based upon standard direct labour costs is more feasible than one which is based on material or a combination of material and labour.

In view of these considerations it seemed desirable to measure activity in the gas heating-equipment plant by an input index of production which was based upon standard direct labour dollars.

PERCENTAGE OF CAPACITY.—Expressing the activity index in terms of a percentage of capacity is common practice in break-even analysis. This conversion camouflages but does not solve the problems that we have just discussed. In addition it raises new problems of determination of "capacity." Capacity is generally conceived in physical rather than economic terms. But even physical capacity often cannot be determined accurately even though it may appear definite. Should it be based on one-shift, two-shift, or three-shift operation? Physical capacity is also affected by operating conditions such as product-mix and the length of time that management is able or willing to defer maintenance. Moreover, minor capital outlays on bottleneck operations can often expand capacity. Hence, it may change frequently.

The benefits that come from expressing activity as a percentage of "capacity" are not very clear. The notion that there is some "safe" break-even percentage makes little sense, for the peril of a particular break-even point depends on the probability that production will go below it. And this probability depends on demand, which has no logical relationship to capacity. Hence, little is added and much may be lost by converting the activity index into a percentage of capacity.

How to Determine the Relation of Cost to Activity Rate

The problem of determining the functional relationships between cost and activity rate, which is a major problem area in break-even analysis, can be attacked in a variety of ways with varying degrees of precision. The methods selected should be governed by a policy decision as to how precise it is desirable to be. High accuracy can (given good measurements of activity and sound rectification of cost observation) be obtained by multiple correlation analysis, but this is expensive. A reasonably good approximation to the static cost functions can be obtained by statistical short cuts, primarily through the use of graphic correlation analysis. The error range with these cheaper methods is usually tolerable practically, particularly when the shifts of the cost function cause estimating errors that are much wider. These shifts come about by changes in the operating conditions that were deemed constant in determining the static cost function. However, the accuracy with which allowance for shifts can be made depends in a large part on a knowledge of the effect of these dynamic factors upon costs. And this knowledge is usually obtainable as a by-product of more refined methods. In any event, sound short cuts can be devised only with an understanding of the problems and methods of more refined analysis. Hence, we shall examine these problems even though simpler methods are contemplated.

Determination of the relationship of cost to activity rate by classification of the accounts is a crude method which is useful primarily for expenses that are either clearly constant or proportionately variable with output. For all items which fall between these two extremes, some sort of statistical analysis is usually necessary to determine functional relationships with acceptable precision. Rough scatter diagrams of a comparatively few observations at the extreme of the output range may be statistical analysis enough.

Normally it is better to work with observations in the form of total expenditures for a period than to work with unit costs. Moreover, separate analysis of the various components of costs is generally desirable, partly because they are significant *per se*, and partly because a better estimate of the aggregate of the components is thus obtained. An analysis of the aggregate of cost is useful, however, as a check.

HOLDING OTHER THINGS CONSTANT.—The problem of actually obtaining the assumed constancy of plant, technology,

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methods, product, and prices has not been satisfactorily solved in most break-even chart analyses. Analysis of past cost behaviour underlies in some degree all empirical cost functions (unless the whole projection is based on engineering conjecture). Yet no past period can be found with the assumed constancy of dynamic factors.

In the empirical work of the economists, chief reliance has been placed on careful selection of the enterprise and the sample period, and by multiple correlation analysis. In normal break-even chart analysis, this kind of sample selection is out of the question. Much use must be made of conjectures that imagine away these difficulties. Multiple correlation analysis has been used with some success in removing the influence of "other factors." But its widespread use in break-even analysis is limited by its expense and unfamiliarity. A shortcut that must be used with discretion is to omit or ignore observations that are distorted by known conditions that you seek to hold constant.

SHAPE OF COST FUNCTION.—What shape of functional relationship between total cost and rate of activity should be expected? A linear total cost function is usually an acceptable approximation for break-even analysis. Economic theorists have generally drawn the total cost function as a curve which rises first at a declining rate and then at an accelerating rate. However, the more meticulous statistical investigations in this field have found the total cost function to be linear over the observed range of the activity rate for several enterprises. The extremes of the shown output range were not explored in these studies, since the samples largely covered operations in the 'thirties. However, the range of output sampled looked wide in terms of the ratios of its high to its low, also in terms of the experience of these companies during the preceding decade.

Several developments since the 'thirties make it conceivable that empirical cost functions would not be strictly linear:—

(1) Overtime wage rates. If they are not removed in the data correction and if they are more common at high output rates, they might make the cost function turn up.

(2) Activity rates that press hard upon physical capacity are found much more frequently in this post-war period than in the 'thirties. Doubtless it is conceivable that operations could crowd capacity to the point of raising marginal cost. The real question is whether this is likely. The cost penalties of super-full production may be so great and so apparent that output in this area is unlikely.

(3) Premium wages for second and third shifts may make the cost function rise in steps at the second and third shift output range. However, clear up to the limit of practical single-shift operation, a linear total cost function is usually good enough.

Research refinements to get more precise estimates of cost functions are expensive. The error range from cheaper methods is tolerable practically, particularly when the shifts in the cost functions due to dynamic changes cause estimating errors that are much wider.

GRAPHIC METHODS.—For most practical analyses, the refinements of mathematical multiple-correlation analysis are not worth the cost. Graphic methods of simple or multiple-correlation will do the job adequately. The graphic technique has advantages in flexibility and in understandability as well as economy. The fact that its results are more subjective than mathematical methods calls for care and experience in fitting functions, but also brings some net advantages.

HOW TO DETERMINE REVENUE FUNCTIONS.—The static revenue function of break-even analysis is drawn under certain assumptions which must be understood to use the results intelligently:—

(1) That the selling price of the product remains constant despite changes in activity rate. Changes in list price call for a new sales line, which alters the break-even point and profit function. Changes in price concessions which may be correlated with activity rate may also shift the revenue function and vitiate the profit forecast made from the static chart.

(2) That the product-mix remains constant. Whenever products differ in contribution margins and when there is variation in product-mix

(Continued on page 371)

Methods and Potentialities of Break-Even Analysis—continued

from period to period, profits will be different at a given output depending upon the product-mix. A different revenue function therefore must be drawn for each significantly different product-mix.

(3) That the distribution-channel-mix remains constant. Changes in the proportion of output that goes through various distribtuion channels is an additional source of differences in net-back[3] which shifts the revenue function (where the contribution margin differs significantly among distribution channels). When the channel proportion is important and unstable and/or correlated with activity rate, a different revenue function needs to be drawn for each expected channel-mix.

The difficulties that stem from these assumptions could be overcome by measuring output in terms of current sales dollars. This would make total revenue a single-valued function of output so measured. But if this is done, cost will not be the same for output of different product composition. Hence, the difficulties thus obviated would be re-introduced in a different and more serious manner in determining the cost function.

The problems of determining a static revenue function under any given set of assumptions are not difficult. What is important is to specify the underlying assumptions and to be equipped to produce a revenue function which will reflect changes in assumptions or a set of multiple alternative assumptions.

(To be concluded)

[3] This expression means the net margin returned.

ACCOUNTING AND ECONOMIC CONCEPTS

In 1945 the Institute of Chartered Accountants in England and Wales and the National Institute of Economic and Social Research entered into informal discussions to promote clearer understanding between accountants and economists.

The report of the joint exploratory committee of the two bodies has issued a report, which has been published by the Cambridge University Press under the title *Some Accounting Terms and Concepts.*

Commenting on this report, *The Economist*, 11 August 1951, says:—

"This essay in terminology and in the basic accounting structures of the profit and loss account and balance-sheet in which the various accounting concepts are assembled, presents a very useful discussion. But it has evidently brought agreement no nearer between economists and accountants when they talk of 'capital', 'cost', 'depreciation', and 'valuation'.

"The report of the joint exploratory committee of the two bodies records this disappointing conclusion quite frankly. The true significance of the main accounting concepts, it declares, rests on the principles to be applied in assessing provisions for the depreciation and depletion of fixed assets and also of changes in inventories. These principles themselves rest on the conception of 'maintaining capital intact' and the eect thereon of the instability of money as a store of value. It has not been possible to reach agreement on this fundamental matter—for reasons that the report makes entirely clear. The accountant—or at least the accountant who follows the guidance of the Institute in this matter—understands that the maintaining of capital intact means the preservation of the money capital subscribed by the proprietors of a business. This amounts to a doctrine that charges against incomings should be based on cost; and the remedy for depletion of capital in the real sense—which is what the economists have in mind when they talk about maintaining capital intact—is to be sought by setting aside a more generous slice from profits to reserves. The report serves a useful purpose in setting out in great detail and clarity the essential differences of approach between the two sides; its truly disappointing feature is that it reveals that economists and the leaders of accounting opinion are so far removed in their thinking on fundamentals."

CURRENT PROBLEMS DISCUSSED IN OVERSEAS JOURNALS

MANAGEMENT ACCOUNTING

One of the most significant developments in industrial management in the United Kingdom in recent years has been the increasing interest which is being taken in the use that can be made of accounting information. There is an evident desire on the part of English industrial managers to know more of the management philosophies which have characterised the American outlook on this question.

This desire has apparently been greatly stimulated by the report of a team on management accounting which visited U.S.A. last year. The report was discussed at a recent meeting of incorporated accountants in London. A report of this discusssion appears in *Accountancy*, April. Brief comments on the team's report are also made in an article by A. H. Marshall in *The Cost Accountant*, April, under the title "Management Accounting and Public Authorities."

The same journal for May 1951 prints a paper by F. Simmonds entitled "Trends in Organisation and Accounting in North America," which is based on the writer's observations during a three months' visit to U.S.A. in 1949 under an Institute of Industrial Administration Travelling Scholarship. Mr. Simmonds makes many interesting comments on such aspects as leadership by management, decentralisation of responsibility, the new concept of responsibility of managers, and management control by means of accounting and costing. He thinks there is a better understanding in U.S.A. of the significance of the facts revealed by accounting reports—to chief executives, superintendents and foremen, employees and shareholders.

In *The Cost Accountant*, April, A. Holdsworth discusses some further considerations in the allocation of overheads. Cost analysis and presentation, he says, should be as simple as is compatible with the objectives of accounting. Overheads are revenue expenditure which is not chargeable to job, product or process costs except by some form of arbitrary allocation. Orthodox accounting for overheads involves three steps—primary classification to cost centres or departments, cost of service centres allocated to production cost centres, and final allocation of production centre costs to jobs or products. There are possibilities of inaccuracies at each step, and allocation of overheads should be embarked on only after careful consideration of its contribution to costing objectives. He advocates the final allocation of total expense to jobs or products: intermediate allocation of fixed costs should be deemed unnecessary unless it is proved to be necessary.

Herbert F. Taggart, in *The Accounting Review*, April, "Cost Accounting Versus Cost Bookkeeping," analyses the four major functions of cost accounting. These are: devising cost accounting systems and procedures, recording cost data (cost bookkeeping), preparing forecasts of costs which serve as the basis for planning and budgeting, and presentation and interpretation of cost data.

There is much confusion of thought because of confusion between accounting and bookkeeping. The American Accounting Association's 1948 statement of concepts and standards says: "The most commonly used financial statements report the origin and disposition of assets in terms of costs established and recorded at the time the assets are acquired." Mr. Taggart believes that both LIFO and depreciation on replacement cost fly in the face of this rule. There is one obvious solution to the present dilemma: that is to go the whole way in the adjustment of costs to current prices, thus bringing the balance sheet back into harmony with the income statement, and restoring the cost principle in substance, if not in its exact original form.

In the same issue of *The Accounting Review*, Myron J. Gordon discusses cost allocations and the design of accounting systems for control. Product, he thinks, is not the appropriate cost unit for control. Costs must be classified by activities for which

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an individual has been assigned authority and responsibility. Accordingly, for control purposes, actual and standard costs should be classified by activities, and should be brought down to the cost centre. Only those costs for which the supervisor is primarily responsible should be reported, and the costs of each activity should be classified by type of cost and by time in adequate detail for statistical techniques. Final cost systems should provide data that non-technical personnel who must use it can understand.

In *The Accountant*, 31 March 1951, E. H. Davison describes the structure of the accounts department for a large manufacturing and selling concern—a public company with several factories at home, involving two or more types of processes, and with several manufacturing subsidiaries at home and abroad. There are three general rules: the organisation of the accounts department should follow the business organisation; past records are of use only as a guide to future actions; and accounting is advisory and informative, not a managerial function. The article includes a most interesting discussion of the relationship of costing and financial accounting, and points to the "growing realization that costing and financial accounting form part of one whole function." The use of standard costs has been hindered by pursuit of an entirely chimerical "actual total cost" built up on the basis of a mixture of facts and assumptions.

In an article entitled "Control of Manufacturing Expense" in *Cost and Management* (Canada), March, R. F. Hogan contends that expense is the most controllable element in costs, but, though it is becoming the dominant cost element, it is less controlled than it should be. He submits a programme for expense control:—

(1) Review departmental organisation to assure that productive operations are intelligently grouped and sufficiently sub-divided.

(2) Organise the chart of accounts so as to guarantee clean-cut, uniform, functional accumulation of expense.

(3) Intensive market analysis so as to determine whether to budget for an expanding or a contracting business.

(4) Determine a standard annual volume and working days.

(5) Determine allowances for each expense account in each department.

(6) Prepare and distribute a performance report, for each general foreman, compared with budget allowances.

(7) Analyse all unfavourable variances with the responsible foreman.

Harold G. Avery, "Accounting for Joint Costs," in *The Accounting Review*, April, confesses that the problem of allocating joint costs is theoretically unsolvable. Practical procedures should be based on standards of reasonableness. The article examines the alternatives of cost allocation by weight, by market or sales value, and arbitrary allocation.

In *The Cost Accountant*, April, G. R. Booth discusses costing in the maintenance department. He points out that the usual practice of works orders for special jobs, often pre-estimated in detail, does not go far enough, and advocates a system of planning maintenance in advance so as to extend the method to small jobs as well as large. This advance planning is useful also in planning the labour force and the materials required, and makes possible the preparation of departmental budgets as a means of control.

Several other articles of a descriptive nature have come under notice this month.

In *The Canadian Chartered Accountant*, March, R. L. B. Joynt, in an article entitled "Office Production and Control," discusses production analysis, work measurement, and production standards for office work, and ways in which peak loads may be handled, and incentives applied. In *The Journal of Accountancy*, March, William V. Deane describes the organisation of the accounting department of the Westinghouse Electric Corporation, which has 2,700 accounting employees, of which 10% are in head office, 20% in district offices, and 70% in manufacturing divisions. The article covers general accounting, factory accounting, pay roll accounting, budgeting, and internal auditing.

J. S. Weyman, in *The Accountant*, 17 March, describes the peculiar features of travel agency accounting, including the extensive use of control accounts, the handl-

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ing of foreign exchange, branch returns, the internal audit and control of stocks of transport tickets, hotel and excursion coupons, and the like.

In *The Journal of Accountancy*, March, there is a study by Ellis W. Goode of the use of punch-card accounting equipment by twenty motor carriers in U.S.A. The characteristic features of this industry from the accounting standpoint are the large number of small transactions, and the many widespread offices. The article deals particularly with the application of punch-cards to revenue accounting, payrolls, statistics, vouchering and check writing and cost information.

John Peoples, in *The New York Certified Public Accountant*, March, examines auditing and accounting aspects of a motor bus company, including classification of accounts, control of fares, accounting for tokens, and audit problems. In *The Journal of Accountancy*, March, Julian Weiner argues for cost accounting as an aid to fixing hospital rates and cutting excessive spending. The article is replied to by Dr. Klarman, who maintains that cost accounting cannot furnish the unique solutions needed for scientific hospital rate making.

In *The Journal of Accountancy*, April, there are two particularly interesting articles on stock accounting and control. One, by F. D. Scott, describes methods in use in the Red Owl chain of stores for ordering, paying for, recording, and charging out stock by means of punched-card equipment. The other article, by Arthur Weiss, describes a new inventory control system which reduces customer complaints and speeds delivery of orders. Orthodox systems either maintain separate records showing the actual stock position and the available balance, or a combined record showing both features. The system described in this article is based on recording of stock reservations, sales, stock receipts and issues. It is claimed that it not only saves a great deal of work, but avoids the frequent misunderstandings which occur under either of the orthodox systems.

In *The New York Certified Public Accountant*, April, there are three interesting articles on air transport accounting. One, by Karl G. Clement, describes airport accounting for the Port of New York Authority; another, by Raymond C. Lochiel, deals with cost accounting in air transport; and the third is a bibliography of airport accounting.

PUBLIC ACCOUNTING SERVICES

Of the many journals which are discussed in this section from time to time, there is no more interesting and useful one than *The New York Certified Public Accountant*. This journal has developed the habit of devoting a large part of each issue to a series of articles dealing with allied problems. Most of the articles are comparatively short, but they are invariably full of information and stimulating thought. One example of the way in which articles dealing with allied topics are gathered together is provided by the three articles to which reference has just been made. Another example is in the March issue, in which there are five articles dealing with aspects of the practice of public accounting. One, by Stephen Chan, describes the variety of services given to business by certified public accountants in such matters as business advice, tax advice, system revision, insurance coverage, and monthly audited reports. Another, by Kermit J. Berylson and Joseph S. Herbert, discusses the accountant's function in the credit-granting process. A new role for accounting is to act as business counsellor and a link between client and the resources of the credit and financial world. The article discusses types of financial assistance, the information which is needed for credit purposes, and ethical relationships between the accountant, the client, and the lender. The third article, by Mario P. Borini, deals with the special problems in the audit of a small business wherein there is limited or no internal control. The fourth article, by John F. Schmonsees, is concerned with the audit of income; and the fifth, by Jack H. Klein, with accountants' staff problems and aids in their solution. This last-mentioned article discusses selection, training, and retention of employees. Possibly many Australian

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practitioners would agree that the third problem is the most difficult of the three.

The Journal of Accountancy, March and April, also has several articles of particular interest to public accountants. One, in the March issue, by Adrian F. Sanderbeck, is entitled "Advice for the New Partner: How to Make Easy the Burden of Increased Duties." In particular, it discusses the problems of learning to supervise the work of others, and to deal with clients on a top-management level. Another article, also in the March issue, by Louis H. Pilie, on how to manage the accounting engagement, is a survey of the methods of eleven successful firms. Stress is laid on the necessity for frequent personal contact with the client, and for early discussions with him, and a written letter setting out the scope of the work, the limit of responsibility assumed, and the basis of charging. The final act, described as administering the report, (that is, presenting it orally) is also discussed. Throughout the course of the work accurate work records are essential, showing work-in-progress and anticipated work obligations to clients, so that the whole of the work of the office can be planned ahead. Attention is given also to methods of controlling time on jobs, to records of the productive time of each assistant, to the use of time-savers such as dictating machines, photostatic equipment, and standard report paragraphs, and to alternative bases on which fees may be determined. The discussion of fees emphasises the interdependence of the professional and the business aspect.

In the April issue Louis Feurer writes on how to check thoroughly a client's internal controls during an audit. A permanent file should be maintained, including a general questionnaire, working papers covering periodic reviews of various phases of the accounting procedures and of the reports to management covering these reviews. The article includes also valuable comments on internal control of purchasing and accounts payable, employee time, and the valuation of inventories.

Another article in the April issue, by John M. Stoy, describes how to set up a time-record system and a client-scheduling file for smaller accounting firms. The system described is intended to be used by firms with from four to forty or more staff members. It is based on the keeping of a daily diary by each staff member, an analysis of non-chargeable time, and a visible card-index for each client, showing essential standing information.

In *The Canadian Chartered Accountant*, March, F. A. Nightingale discusses audits of closely-held companies. Companies referred to are analagous to Australian proprietary companies. It is suggested that the work in such audits is much more delicate than in the case of public companies because of the fact that very often employees are also shareholders, sometimes large shareholders. The personal element in such audits is most important. Often there is a lack of appreciation of the auditor's responsibility, and a tendency to restrict the scope of the audit. Differences of opinion as to personal expenses charged as operating costs, and as to the distinction between profit and taxable income, often arise, and need to be handled with tact as well as firmness.

In *The Accounting Review*, April, J. B. McGladrey deals with three important questions:

(a) how best to indicate clearly the auditor's responsibility;
(b) what information should be included in the report; and
(c) how the information should be presented.

There are three possible ways in which the auditor's responsibility may be defined—by giving an unqualified opinion, by giving an opinion with qualifications, and by specifically disclaiming an opinion. As to the extent of the information which should be included in the report, the minimum is a statement of the scope of the audit and the auditor's opinion, the financial statements, and notes thereon, with comparative statements in appendices. On the third question, the article deals with report arrangement, statement form, and terminology. There is a clear necessity for public accountants to get together on major matters such as the presentation of income and reasonable uniformity in important terminology. Minor details may be left to individual preference.

In *The Accountants' Journal*, May, a case of particular interest to auditors is reported. This is the case of *Candler* v. *Crane, Christmas & Co. and Another*,

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[1951] 1 All E.R. 426. This was an action brought by a third party to whom draft accounts prepared by an accountant were shown. Later, after the plaintiff had invested in the company, the statements were signed by the accountant, and they were afterwards shown to give a false picture of the position of the concern. The defendants were held not to be liable for negligence. The article refers to the *Ultramares Case* in U.S.A., and concludes with "the law of U.S.A. and the law of England with regard to liability for negligent words seems to be similar. Unless privity of contract can be shown, no action will lie."

In *The Accountants' Journal* (N.Z.), F. M. Bell describes a novel method of valuing unlisted shares by a points system. Points are allotted according to a formula as under:—

Number of years in business—
2 for each year, with a maximum of 20

Ratio of fixed assets to fixed liabilities—

$$15 - \left\{\frac{\text{F.L.}}{\text{F.A.}} \times 15\right\},$$

with a maximum of 15

Ratio of current assets to current liabilities—

$$20 - \left\{\frac{\text{C.L.}}{\text{C.A.}} \times 20\right\},$$

with a maximum of 20

$$\frac{\text{Reserves}}{\text{Paid-up capital}} \times 10,$$

with a maximum of 10

Patents, trade marks, rights, etc.—

$$\frac{\text{Gross profit on sales under trade marks}}{\text{Gross profit on total sales}} \times 20,$$

with a maximum of 20

At valuer's discretion 15

Total maximum points 100

Where there are restrictions on sale, 10 points are deducted, except where the valuation is being made for death-duty purposes.

After calculation of the points, maintainable profits are capitalised at 6% and multiplied by the ratio of points allotted to total possible points. The article compares the results obtained by the method, in selected cases, with those obtained by the super-profits method and by the capitalisation of profits method.

VALUATION OF GOODWILL OF ACCOUNTANCY PRACTICES

A contributed article in *Accountancy*, April, deals with this important matter, about which, despite the frequency with which it arises, very little has been published. The article suggests that a great variety of factors should be considered, including the personalities of the incoming and outgoing partners, whether the outgoing partner will maintain any connection with the practice, the nature of the fees receivable, and particularly the extent to which they are recurring or not, the situation of the office, whether it is in a growing business locality, whether there is intense competition, and whether there is a good class of clients, trends in profits, the state of the practice, particularly whether the work is up to date, the part played by the partners in professional and public activities, their seniority in the profession, and the tenure of premises. Several methods of valuation are discussed, including the methods of a two to three years' purchase of the net profits averaged for a period of from five to ten years; the average annual super-profits method; one, two, or three years' purchase of gross fees; and one to three years' purchase of gross fees excluding non-recurring fees. The writer expresses a preference for a method of paying a percentage of the gross fees on a reducing scale for three to five years following the sale of the practice. The present trend in England is said to be to arrange for payment for goodwill over a period.

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TAXATION

An article by Dorothy G. Willard in *The Journal of Accountancy*, April, considers the accountant's responsibilities in preparing income tax returns. These responsibilities are to the client, to the public, to the accountant himself, and to the government. The importance of a clear understanding as to the scope of any assignment is emphasized, as is also the necessity for retaining full information, with a record of the sources of the data. Legal and moral responsibilities for negligence, mistake of judgment, and bad faith are examined.

In view of the discussions which have taken place in Australia for many months about an excess profits tax, particular interest attaches to two articles in *The New York Certified Public Accountant*, March, on the new Excess Profits Tax Act in U.S.A. David Zack explains the elections, options and alternatives in the Act, which, doubtless with a view to stressing its importance to the profession, he records as having been enacted on the 3rd January 1951, at 10.13 a.m. Eastern Standard Time! The Act affects companies only, and the opinion is expressed that practitioners "are faced with perhaps the most prodigiously complex piece of tax legislation in the nation's history." At the same time, it is recognised that "a truly simple law would indeed be the severest and the most bitter pill for the taxpayer to swallow." The other article is a series of questions and answers on the Act by Harry Janin.

SELECTION OF ACCOUNTING PERSONNEL AND POST-GRADUATE EDUCATION

In *The Journal of Accountancy*, April, Robert N. McMurray says that a study of personality traits may be the key to choosing the valuable accounting junior. In addition to intelligence and technical competence, an entrant to the profession should have many other qualities. He should be occupationally stable and uncomfortable when idle. He should have the habit of thoroughness, be a good team member, be self-reliant and be able to fend for himself, have the ability to get along with others, and possess a good sense of discipline, imagination, and good judgment. The technique of selection is to know clearly the technical and psychological qualifications, to use a good test of intelligence, and a fixed interview such as would permit the interviewer to explore all facets of the applicant's background.

It is coming to be recognized that accountants need facilities for continuing their education after they have passed their entrance examinations. In *The Journal of Accountancy*, March, John E. Mulder explains the methods by which continuing professional education for lawyers in U.S.A. is accomplished. The main ways are through lecture courses supplemented by concise, practical literature, and by the publication of handbooks by legal associations.

ACCOUNTING REPORTS AND STATEMENTS

C. E. Jarchow, in *The Canadian Chartered Accountant*, writes on the influence of reports on top-management decisions. The basic rules for useful accounting reports are that they should be presented promptly, and promptness should not be sacrificed to accuracy in unimportant details, that they should be expressed in simple terms, be objective, comprehensive and complete, and basically prophetic rather than merely historical. The assumptions on which results of special investigations are made should be set out clearly. To be useful, a report must tell the story clearly and simply, and must be properly interpreted. Examples are given of reports of use to management in the fields of financing, production, engineering, distribution, and industrial relations.

The first part of a paper by Thomas Lister, entitled "Accounting Statements—A General Formula," appears in *The Accountant's Magazine* (Edinburgh), May. The writer lays emphasis on the requirement that accounting statements shall give a true and fair view. Distortions result from the accounting rule that unrealized losses must be brought in, and unrealized profits ignored. Examples are given of "new model" statements for merchants,

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manufacturers, hire-purchase traders and contractors, which avoid these distortions. Mr. Lister contends that the accountant should not be afraid of straying from the path of orthodoxy when traditional doctrine is founded on unsound premises.

The Accountant, in its issues of 16 December 1950, 3 February and 7 April 1951, published a series of three articles on published accounts. In the issue of 7 April, L. C. Mather, a banker, states the viewpoint of a creditor. There are two separate but complementary approaches by a banker: one is on the going-concern basis, the other on what might be called the gone-concern basis. On the first-mentioned basis emphasis is placed on liquidity and on working capital, and such ratios as trade creditors to purchases, stock to sales, and debtors to sales. Recent results are also obviously important. On the second-mentioned basis, emphasis is on break-up values, and for this purpose schedules of fixed assets showing date of acquisition and depreciation provided, of investments, with break-down of stock into materials, work-in-progress, finished goods and supplies, of large debtors, of liabilities, showing preferences and securities held, and of rates of turn-over of stock, are needed. The article examines two different forms of balance sheet, one the two-sided form based on the balance-sheet equation, liabilities + proprietorship = assets; and the other the one-sided form based on the equation, proprietorship = assets — liabilities. A slight preference is expressed for the one-sided form. .

In *The Accountant,* 21 April, W. H. Lawson sums up from the accountant's standpoint on the three previous papers written by an investor, an economist, and a banker respectively. A great part of this article is devoted to comments on the views expressed by the economist as to the need to change accounting practices to reveal economic profits. There are three important aspects:—

(a) is purchasing power available to buy goods at the prices which would be necessary to recover economic cost, and would an attempt to fix prices on this basis not add to inflationary pressures?

(b) would it be possible and fair to protect all investments except government securities against inflation? and

(c) if the tax base for business profits is changed, would not a heavier burden be placed on the rest of the community?

The article has also many interesting things to say about the need, and demands, for additional information in published accounts.

Another article on published accounts, written from the standpoint of the banker, is by Ralph L. Stauffer, Chairman of the Committee of the American Institute of Accountants on Co-operation with Bankers, in *The Journal of Accountancy,* March. This article discusses the additional information required by bankers, and points out that this information is often not germane to the main objective of an audit. It is reasonable to think that, if bankers require it, they should make special arrangements for it to be included in the statements.

It is always an open question to what extent development of accounting standards should come voluntarily from within the profession, or be forced by legislative requirement or regulation. In *The Journal of Accountancy,* March, Harry A. McDonald, Chairman of the Securities and Exchange Commission, reviews the joint efforts of the Commission and professional bodies in America to develop accounting standards which will be of help to investors. He emphasizes the importance of keeping accounting objective and uniform, not only to prevent manipulation of accounts, but also to avoid unconscious distortion through honest differences of opinion. Point is given to this aspect by discussion of the controversy in U.S.A. regarding the income statement, particularly as to the treatment of abnormal items.

Two opposite points of view are given in *The Journal of Accountancy,* April. W. F. Stanley maintains that financial statements should show earnings and dividends per share. The practice of investing in shares is now widespread. Many shareholders are not expert in analyzing public statements, or have not the time to do so. One way in which they can be helped is to show earnings per share, after allowing for preference dividends. J. E. Robertson expresses

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the opposite viewpoint. Earnings per share have little significance as an expression of operating results, and it is undesirable to encourage shareholders to rely upon them. Their significance is lessened by the intrusion of extraordinary items, and there is great danger in attempting to over-simplify the complex problem of financial reporting.

It seems likely that it will not be long before an application of funds statement becomes part of the set of annual financial statements issued by companies. In *The Journal of Accountancy*, April, Emmett B. Day suggests that a cash-balance approach to the funds statement promotes clarity in financial reports. The contention is illustrated by a re-arrangement of the funds statement of the United States Steel Co. in a form which, beginning with the cash resources at the start of a period, adds the funds provided during the period, deducts funds applied, and finishes with the cash resources at the end of the period.

ACCOUNTING TERMINOLOGY

The Accounting Review, April, contains a supplementary statement by the Committee on Concepts and Standards Underlying Corporate Financial Statements of the American Accounting Association on the question of reserves and retained income. The Committee believes that the term reserve should not be used, and that the reserve section in a balance sheet should be eliminated and its elements shown as deductions from assets or liabilities or retained income. Appropriations of retained income should not be made or displayed in such a manner as to create misleading inferences. In particular:—

(a) all retained income which has, in fact, been committed to operating capital should be earmarked;
(b) appropriations required by law or contract should preferably be shown by footnote: if they are separately shown in the balance sheet they should be included in the proprietorship group;
(c) appropriations reflecting anticipated future losses or conjectural past or present losses are preferably shown by footnote: if not, they should appear in the proprietorship group; and
(d) whenever appropriations are shown in a balance sheet, retained income should be summarized in one total.

Determination of periodic earnings is not affected by appropriation of retained income or by restoration of such appropriated amounts to unappropriated retained income.

In the same issue of *The Accounting Review*, S. Y. McMullen, a member of the Committee, makes an analysis and interpretation of the statement.

ACCOUNTING THEORY

In *The Accounting Review*, April, Joseph A. Mauriello, in an article entitled "Relationship Between Accounting and Management," explores the ways in which managerial concepts and views are reflected in the accounting principles, quasi principles, and conventions which are implicit in the term "current accounting standards." The responsibility of accounting to management is a primary one. It has two important aspects—the distinction between capital and income, and the significance of earnings. Recognition of the second aspect leads to emphasis on the income statement, the concept of a sharpened income statement, the use of functional account classifications, and of budgetary statements and comparisons, and a continuing re-examination of the processes of determining net income, including the conflict between historical cost and economic cost.

Bradbury B. Parkinson, in *The Accountant*, 28 April, deals with the remarkable gulf between the two professions, accounting and economics. Attempts to establish a common terminology are making no progress, in fact discussion cannot even begin. This is well exemplified by the different standpoints of the two professions in their attitude towards income and profits. The article, written by an economist, shows unusual appreciation of accounting problems and aims, and of the uses of accounting.

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As an immediate programme for accountants, the writer says: "The task of accountancy is to improve and clarify its technique, to ensure a balanced development, and to aspire to a reconciliation of results with economic aims. Economics, after familiarizing itself with the many difficulties facing accountancy, must provide practical and discriminate guidance in adapting accounts to economic aims, giving expedient definitions of income and its analysis, and showing how customary procedure may be readily converted. It is not a question of achieving a result that is perfect, but of achieving a result that economist and statistician will be satisfied with under the pressure of circumstances. Only along these lines can any expedient measurement of individual and industrial income be made; only in this way can the subjects of accountancy and economics begin to coalesce for the achievement of social aims."

In *The Journal of Accountancy*, April, Professor Lloyd Morey points out that "accepted accounting principles" are usually so expressed as to apply only to profit-making enterprises. He raises the question whether they apply also to government and other non-profit-making accounting, and maintains that they do not. The question is important in the United States in view of the standard use in audit reports of the expression "prepared in accordance with generally accepted accounting principles."

Two articles in *The Accounting Review*, April, have something new to say about the problem of accounting and inflation. Russell Bowers, on business profit and the price-level, says that there is no general consciousness of the distinction between money profit and real profit such as is common in the case of wages. The problem of converting money profit into real profit is much more complicated than that of converting money wages into real wages. Results of past transactions should be converted to current money values by use of the most general price index available: special objections can be raised against the use of special indexes. Business decisions seem to be based on nominal profits as though they were the same as real profits. In a long period of price rises, nominal profits exceed real profits. There is no dearth of investment supply during such periods, and therefore no inevitable bankruptcy from a failure to distinguish between the two. An economic fallacy, however, lies in the more fundamental question of possible misdirection of economic resources generally. Allocation of resources can be effected more clearly in response to conscious purpose or intent if it is made on the basis of a measuring unit of constant value. If the value of money is unstable, the next best policy is to correct costs and revenues.

Joel Dean, on the measurement of profits for executive decisions, contends convincingly that profit should be measured differently for different purposes, and that, in fact, three sets of accounts are needed, one showing statutory income for taxation purposes, one showing accounting income, and one showing economic income.

Most university instructors in accounting have had impressed upon them the need for sound basic education in accounting theory as a preparation for practical work, and for a course in accounting theory for use by people who need to understand accounting theory for their own purposes, without necessarily needing intensive technical training. In *The Accounting Review*, April, Robert E. Walden states the case for a course in accounting theory. Sound theory, he says, is the basis for good practice, but there is a lack of emphasis on theory in most curricula. Students in related fields need an understanding of the basic philosophy of accounting without having to take numerous courses stressing techniques. An outline of a satisfactory course would cover early history of accounting; the relationship between economics and accounting; fundamental accounting concepts; statements of accounting principles; accounting and the price-level; accounting for individual balance-sheet items, and their relationship to income determination; and the content and structure of financial statements.

The addresses of publications referred to in this article are as follows:—

Accountancy,
Incorporated Accountants Hall,
Temple Place,
Victoria Embankment,
London, W.C.2, England.

The Cost Accountant,
63 Portland Place,
London, W.1, England.

(*Continued on page* 381)

Current Problems—continued

The Accounting Review,
450 Ahnaip Street,
Manasha,
Wisconsin, U.S.A.

The Accountant,
4 Drapers Gardens,
Throgmorton Avenue,
London, E.C.2, England.

Cost and Management (Canada),
66 King Street East,
Hamilton,
Ontario, Canada.

The Canadian Chartered Accountant,
10 Adelaide Street East,
Toronto,
Ontario, Canada.

The Journal of Accountancy,
270 Madison Avenue,
New York 16,
New York, U.S.A.

The New York Certified Public Accountant,
677 Fifth Avenue,
New York 22,
New York, U.S.A.

The Accountants Journal,
22 Bedford Square,
London, W.C.1, England.

The Accountants Journal (N.Z.),
York House,
Lambton Quay,
Wellington, C.1, N.Z.

The Accountant's Magazine (Edinburgh),
4 Rothesay Place,
Edinburgh 3, Scotland.

MANAGEMENT ACCOUNTING IN AMERICA

A REPORT OF THE ANGLO-AMERICAN COUNCIL ON PRODUCTIVITY

In 1948, on the initiative of Sir Stafford Cripps, then Chancellor of the Exchequer, and Mr. Paul Hoffman, Economic Co-operation Administrator in the United States Government, there was established The Anglo-American Council on Productivity. The purpose of the council is "to promote economic well-being by a free exchange of knowledge in the realm of industrial organisation, method and technique, and thereby to assist British industry to raise the level of its productivity". The principal means whereby these aims are achieved is to send to America industrial teams to study American production and administrative methods and to report their observations and findings.

During 1950 the Council appointed a team of industrial accountants to visit the United States of America "to find out what accounting, costing and statistical information is provided for American Management at different levels, by what methods it is obtained and how it is used." The report of this team has now reached Australia and it contains much that will be of interest and use to Australian accountants and business executives.

Unfortunately, copies of the report will not become readily available and as the information contained in it is of some importance the purpose of this review is to give, in summary, the principal findings of the team.

It is emphasised time and time again throughout the report that the chief impression of the team was the effectiveness of American industrial management in achieving high output and low cost, and that one of the chief contributing factors in attaining this was the "cost consciousness" of business executives. Apparently there is, in America, a widespread belief that the standard of living of the people as a whole can only be raised if industry can be made to produce cheaply at a high level. Consequently, with this motivation, the American business man looks to his accountant far more than is the case with his British counterpart, for information about the cost of his products with the purpose of so planning and controlling his activities that the abovementioned twin aims are achieved. As a result, the industrial accountant in America occupies a more important place in the business executive hierarchy than is the case in England. The report of the team emphasises the importance placed on the position of the comptroller in American industry and also on the way in which this executive's duties have developed from purely accounting activities to those of analysing and reporting to the management on all phases of the business. It is emphasised that to carry out the duties of a comptroller a person must have a sound appreciation of technical processes and the problems of management, and consequently,

Management Accounting in America—continued

he comes to be identified more with the attitude of management than with that of the accountant. The result seemed to the team to be a much closer and more sympathetic relationship between the technical and financial executives of business than existed in England; a situation which could be productive only of good.

The team found that cost information was used principally for planning and control of production. For planning, forecasts are needed of the trend of outside events which are beyond the control of management and also of events which are subject to managerial control. In the forecasting of outside events there are available voluminous statistics about every phase of business, many of which are collected and published by government agencies and trade associations. These statistics are only available because industrial enterprises voluntarily disclose information about their activities, to an extent which the team thought would not be possible in England. Apparently the average English business man is afraid that his competitors will benefit from the disclosure of information about his business. Nevertheless, the team is of the opinion that the widespread and effective use which is made of budgeting would not be possible without this information.

For control purposes actual results are collected and are compared from time to time with the target set by the budget to see whether plans are working out successfully or whether changes in policy are needed. A point which impressed the team was the speed with which information about the cost of operations was collected and presented to management so that comparisons with budget could be made. To achieve this speedy compilation a highly efficient office force is required and the team is of the opinion that office organisation receives as much consideration as factory organisation and is considered to be of equal importance.

The report emphasises that the accounting techniques used are not new and all are well known in the United Kingdom but what did impress the team was their widespread application and the speed with which their results are made available to management. It was found that practically every company uses some form of budgeting; most companies use some form of standard costs, and historical costing systems are rarely found. The team found many instances where complete cost information was available within three days of the close of a month and, for the control of day-to-day operations, particularly of labour, information about a day's operations is available at the start of the following day; sections of the accounting staff working on shifts to achieve this.

One point of tremendous importance emerges from a study of the report. It is the close attention which American industrial accountants pay to the planning and preparation of their reports. It is obvious that the system of accounting reports used in an industrial enterprise is tailored very closely to fit the needs of the various executives. For example, the team noted a big difference in the accounting information supplied to junior and senior executives. Senior management receives voluminous reports every month so that it may carry out its principal task of planning for the future and setting targets of performance. On the other hand, it was noted that the nearer an executive is to the shop floor and the customer the more interested he is in information about day-to-day operations so that he can make decisions for immediate action; consequently, the accounting reports provided for him are brief and narrow in scope.

It appears from the report that American business executives are convinced that academic training for business is well worth while and they actively support the schools of accounting and business attached to the various universities. The team also noted that these schools are staffed by men of considerable practical experience and consequently the courses taught are designed to produce graduates equipped to deal with the current problems of business.

Finally, a paragraph from the conclusions of the team which should be taken note of in Australia:—

> "Managers and industrial accountants are conscious of the gap between management and accountancy, and the need to bridge this gap. On the whole, they have succeeded far beyond the normal achievement in this country."

K. C. KEOWN

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THE CLEARING HOUSE

CLASSIFICATION OF ASSETS

Mr. A. A. Fitzgerald's article, reprinted in the March issue of *The Australian Accountant*, mentions the economists' requirements in accounting statements.

Except within very narrow limits, there are no observable absolutes in ordinary business activity; from which statement one might conclude that there cannot, except in a few rare cases, be any absolute form of description of those activities which financial statements purport to comprise. One cannot reasonably express the financial condition of a business entity in the form of an accounting statement except from a particular point of view. For example, it is suggested that the balance sheet of a business viewed as a going concern, which fully and fairly stated the condition of that business, and a balance sheet of the same firm at the same point of time, constructed to show its net realisable value at that date, may contain notable differences, particularly in the values ascribed to land, buildings, operating plant and equipment (the "fixed assets"), and goodwill, licences, etc. (the "intangibles").

It is doubtful if any steps which do not include this problem of valuation of assets as a basic essential in determining the form and content of accounting statements will resolve the accountants' or the economists' difficulties.

A point worthy of considerable attention is that the technique of valuation requires analysis and improvement before we may superimpose the complications of form and content on an acceptable accounting statement.

We are nowadays well aware of the fact that the theory of value forms a considerable part of the theoretical subject-matter of economic science, and there are at least four semi-independent aspects of value, viz.: utility, cost value, exchange value, and esteem value.

Mr. Fitzgerald's classification of assets on the Keynesian model would be commonly valued by accountants in something like the following manner:

Current—

- Cash, Book Debts — Exchange value
- Short-term Investments, Prepaid Expenses, Stocks and Work-in-progress — Cost value

Non-current—

- Land, Buildings — Cost value
- Durable Equipment — "Adjusted" cost value
- Long-term Investments—Cost value
- Deferred Charges—Esteem value, or cost value
- Goodwill, Patents, Trade Marks — Cost value, or esteem value

The total value of these assets on an accounting statement is a figure which serves no other purpose than to imply that the statement is arithmetically exact.

I have the impression, in reading the *General Theory*, that the nicer questions of accounting valuation did not occur to Keynes when he was formulating the S=I equation, and that the actual descriptive work necessary to verify the equation econometrically was not attempted by him to any serious extent.

When Keynes, Hicks, or Pigou for that matter, refer to values of assets, they take the values as determined, and seldom (*quae* economists) attempt to discover how those values should be arrived at. Keynes may well regard finished stocks as part of capital in his system, but, as a theorist, he does not have to clear the hurdle presented by the fact that the money-cost values of current and non-current assets are strictly comparable only under the conditions that the value of money does not change between the initial and final dates of acquisition. Keynes says in his static model "*ceteris paribus*," but in an accountant's description of one isolated dynamic series, *ceteris* will not stay *paribus*, and no fiction of accounting has been developed to cope with the situation.

It is submitted that the modern economists, including Keynes, are not formulating their theories of capital and investment (or "asset formation") in terms of

The Clearing House—continued

cost and exchange values at all. The capital in Keynes' schedule of the marginal efficiency of capital and trade cycle theory is not cost value or replacement value of capital—it is utility; and accountancy is not yet equipped to measure utility. If this is true, then we must to some extent forego our immediate attempts to follow economic thought with accounting methodology.

A first essential would be classification of assets in accounting statements with an adequate distinction drawn between the various methods of classification of those assets and an indication as to the view taken of the business in the statement (i.e. whether as a going concern or not). Once the reader of such a statement has made his reservations, then economics may and could be applied to some effect and some small but sure forward steps will be made possible in the fields of both accounting and economic research.

Sydney. DAVID CANTLE.

Have you anything to clear?

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SCOTLAND

Mr. R. G. Simpson, M.C., C.A., of Edinburgh, the President of The Institute of Chartered Accountants of Scotland, has announced the completion of the amalgamation of the three Scottish chartered accountancy bodies.

Hitherto Scottish chartered accountants have been members of one of three bodies: The Society of Accountants in Edinburgh (incorporated by Royal Charter in 1854), The Institute of Accountants and Actuaries in Glasgow (incorporated by Royal Charter in 1855), The Society of Accountants in Aberdeen (incorporated by Royal Charter in 1867). Now they are all members of The Institute of Chartered Accountants of Scotland. Under their charters they are the only chartered accountants who are entitled to use the designation "C.A."

The amalgamation has been effected by the granting to the Edinburgh Society of a Supplementary Royal Charter which changes the name of that Society to that of the new Institute and provides for the amalgamation with it of the former Glasgow and Aberdeen bodies. Although, therefore, the name of the Institute is a new one, members, who number some 5000 and are to be found in almost every country, can take pride in the fact that they are members of the oldest body of chartered accountants in the world.

The Institute is managed by a Council which will meet alternately in Edinburgh and Glasgow. There will also be Local Committees in these cities and in Aberdeen and Dundee, and close co-operation is also to be maintained with Scottish chartered accountants in London.

The principal objects of the amalgamation are generally to enhance still further the standing of Scottish chartered accountants (whether in professional practice or otherwise) and to strengthen the co-ordinated arrangements for the education, training by apprenticeship, and examination of those seeking to qualify for admission as chartered accountants.

COST CONSCIOUSNESS AND PRODUCTIVITY

by
A. H. BLAMEY

Many references to the value of costing are made in the reports of Anglo-American Council of Productivity teams that have studied American industry.

The members of one specialist team that examined packaging in America were impressed with the way costing was appreciated. "What is interesting," they reported, "is a general awareness of what costs really are. The awareness has been created—or encouraged—by an attitude of mind which treats cost as a 'tool' and not as a secret formula secure behind locked doors. To say this does not mean that the complete factory cost of an item is common property. It does mean that the cost element of an operation or a particular process is known by the men responsible for conducting that operation. We are accustomed to the facility with which individual Americans can quote the cost of a highway, a bridge or a television land line. We incline perhaps to overlook the significance of their attitude of mind by thinking too much of the probable accuracy of the figures quoted. In general conversation this really matters little. The awareness of costs remains a general characteristic and the accuracy of the figures increases as one gets nearer to the source—the job and the man.

"We found that the man on the job was well informed of the value of the equipment he was operating. It seemed that the fact was banged into his head, and not left for him to ferret out for himself. The value of buildings and floor space was no less well known to those who used them. It may well be that the impetus behind mechanical handling, pallet loading and stacking (all conservators of floor space and utilisers of "air space") has been increased by the already understood significance of these things in terms all can understand; the dollar value of buildings in general and of floor space in particular.

"It was noticeable that increased production in many directions had been achieved within the existing factory space. True there is much expansion and rebuilding, but not on anything approaching the overall scale on which output has been increased. We suggest that the general familiarity with dollar values and costs aided this advance in technology."

Members of the British team on grey-ironfoundries were also greatly impressed by the widespread use of costing in the foundries visited. An extract from their report states:—

"Even more impressive was the way in which costing was widespread in each foundry. Not only did the bookkeeper understand the cost system, not only did the foundry manager and the treasurer and the secretary understand it, but in many instances the foremen had some understanding of the system and had a good knowledge of the costs of their own particular departments.

"We offer no apology for the frequent references in this Report to 'cost-consciousness'. It was in itself an education to the Team to find that nearly every foundry 'guide' could give details of costs and knew what those costs comprised.

"Even more interesting were the local cost associations. Seventeen or eighteen such groups have been formed already. Each group embraces those foundries in a particular locality whose operations are sufficiently similar to justify cost comparisons.

"The members of a local cost group send to a group cost consultant each quarter a record of their costs analysed into a standard series of cost accounts (as recommended in the Basic Cost Manual).

"The cost consultant for the group then prepares a summary of the quarterly figures forwarded by the members. This summary shows each foundry's more significant figures, such as departmental costs per pound, departmental on cost percentages, yield, melting loss, customers' returns, foundry scrap, output per productive worker and so on.

Cost Consciousness and Productivity—continued

"No foundry names are disclosed; each member is allotted a code number. The main figures for preceding quarters are ranged beside those of the current quarter.

"The management of each foundry is able to see the trend of its costs and to compare it with those of other foundries in the neighbourhood. It is thus possible to distinguish general costing trends among all foundries from trends in individual units, and inefficiencies are thereby disclosed."

In "What We Can Learn from the Americans," Phillip F. Dyer, in an article in the March 1951 issue of *Business*, presents a digest of the twenty-two reports so far issued.

Among the twelve ways in which, he claims, productivity can be increased are two with particular reference to costing.

1. Use the figures your accountant provides as the basis of planning—and see you get them quickly.
2. Keep a close eye on day-to-day variations in cost and get every one in the firm equally cost conscious.

Other ways for improvements listed are:—

Mechanise every operation that can be mechanised.

Scrap a machine as soon as something better is available, even if it still works efficiently.

Don't leave design to the other man—use your own improvisations to improve your plant.

Cut movements of material to the bone; if you have to move something, move it mechanically.

Simplify your programme — cut down the range of sizes, shapes, colours, to the half-dozen most popular, and sell these hard.

Standardise designs to get long production runs.

Even on jobbing work, intelligent planning and design can achieve partial standardisation.

Plan ahead to get a steady flow of work.

Use skilled labour for skilled work. Use unskilled labour to serve the skilled worker.

Keep your workers in the picture. Tell them what is happening and why it is happening.

Reward initiative — by payments for suggestions, by bonus payments, by promotion from within.

Cost accountants as well as other executives would do well to study these reports carefully. Following is a list of titles of the reports which are available in the Commonwealth Institute of Accountants' library in Melbourne:—

Materials Handling
Simplification in Industry
Simplification in British Industry
Packaging
Management Accounting
Productivity Measurement in British Industry
Steel Founding
Cotton Spinning
Cotton Doubling
Cotton Weaving
Drop Forging
Building
Internal Combustion Engines
Pressed Metals (Deep drawn)
Clothing (Men's outerwear)
Fertilizers (Superphosphate and Compound)
Electric Motor Control and Switch Gear
Grey Ironfounding
Electricity Supply
Diesel Locomotives
Meat Packaging and Processing
Rigid Boxes and Cartons
Letterpress Printing
Hosiery and Knitwear
Non-ferrous Metals

LEGAL SECTION

Edited by

J. M. GREENWOOD, LL.B., F.I.C.A.

LEGAL INTERPRETATION: MEANING OF "THE TENANT'S FAMILY"

Members of the tenant's family are entitled to protection under s. 12 (1)(*g*) of the *Increase of Rent and Mortgage Interest (Restrictions) Act* 1920 (Eng.).

Held (Court of Appeal): that first cousins were not "members of the tenant's family" within the meaning of the section.

Sir Raymond Evershed, M.R., referred to Pistol's words in *Henry V* (Act IV, sc. I), "... art thou officer? Or art thou base, common and popular?", and added: "The word 'family' is used here, if I may borrow the words used of the soldier in *King Henry V*, in a sense base, common and popular." Two classes of case may arise in ordinary parlance, he considered. The first is where the only really relevant consideration is that of blood relationship or consanguinity. The second is whether, apart from or in addition to consanguinity, there are special circumstances which require an affirmative answer to the material question, e.g. an adopted child, or a niece by marriage who by her conduct assumes a filial character (cf. *Brock* v. *Williams*, [1949] 1 All E.R. 715).

The present case was considered to be of the first class—"if the consanguinity test is satisfied in the present case, it will extend the formula to relations of every degree, and, indeed, would mean that we were substituting for the word 'family' in para. (*g*) the word 'relation'." (*Langdon* v. *Horton & Anor.*, [1951] 1 All E.R. 60.)

In another case, heard about the same time, it was held that a housekeeper and her husband and child were not members of a tenant's "family," the term not extending to include persons in a household as members of the householder's staff. (*Darnell* v. *Millwood*, [1951] 1 All E.R. 88.)

CERTIORARI: ERROR OF LAW ON FACE OF DECISION OF A TRIBUNAL

The employment of a clerk to a hospital board was terminated when hospitals were "nationalised" in England, and he was awarded certain compensation by the Northumberland Compensation Appeal Tribunal. He moved in the High Court (King's Bench Division) for an order of *certiorari* on the ground that there was an error on the face of the decision and that the Court had jurisdiction to set it aside as being erroneous in law.

Held: as the tribunal had stated on the face of the order the grounds on which they had made it and as it appeared that in law those grounds were not such as to warrant the decision to which they had come, *certiorari* would issue to remove the order into the High Court to be quashed.

Per Lord Goddard, C.J.: "I think that the decision to which we are now coming will be very beneficial because so many tribunals are now set up, all of whom, I am certain, desire to do their duty in the best possible way, but they are often given very difficult sets of regulations and statutes to construe. It must be for their benefit, and I have no doubt they will welcome it, that this Court should be able to give them guidance." (*R.* v. *Northumberland Compensation Appeal Tribunal, Ex parte Shaw*, [1951] 1 All E.R. 268.)

WILLS: WHAT CONSTITUTES A VALID CHARITABLE GIFT?

"It is a long cry to the age of Elizabeth and I think what is needed is a fresh start from a new statute." So said Lord MacDermott in *Oppenheim* v. *Tobacco Securities Trust Co. Ltd. and Others*, [1951] 1 All E.R. 42.

The Statute 43 Eliz. ch. 4 was passed in 1601 to provide machinery for preventing the misappropriation of funds devoted to charitable purposes, and its preamble sets out a number of purposes for which property had been given with "charitable intent": "some for Relief of aged impotent and poor People, some for Maintenance of sick and maimed Soldiers and Mariners, Schools of Learning, Free Schools and Scholars in Universities ... some for Marriages of poor Maids, some for

Legal Section—continued

Supportation, Aid and Help of young Tradesmen, Handcraftsmen and Persons decayed . . .".

These purposes strayed beyond the "popular" meaning of charity and created a "technical" meaning which the Courts have attempted to apply in very changed conditions during the following three centuries. To a suggestion for the Inland Revenue authorities in 1891 that "charity" should be interpreted in its popular meaning, Lord Macnaghten resolutely replied: "I can find no authority for such a proposition. Words must be taken in their legal sense unless a contrary intention appears" (*Comrs. for the Special Purposes of the Income Tax* v. *Pemsel,* [1891] A.C. 531). His Lordship then went on to group charitable purposes under four main heads, namely:

(1) trusts for the relief of poverty,
(2) trusts for the advancement of education,
(3) trusts for the advancement of religion,
(4) trusts for other purposes beneficial to the community.

Courts, ever since, have endeavoured to fit charitable bequests into this framework, but it is becoming more and more difficult to do so, as Lord MacDermott well recognizes.

The facts of the *Oppenheim Case* were that A and his wife settled investments upon trustees to apply the income in a certain manner during their joint lives and the life of the survivor, and thereafter "in providing for or assisting in providing for the education of children of employees or former employees of the British American Tobacco Co. Ltd. . . . or any of its subsidiary or allied companies. . . ." Here, of course, was a perpetuity, and on the death of A and Mrs. A the trust would fail unless the objects were charitable. Charitable trusts, be it remembered, provided they commence within the time allowed by the rules against perpetuities, are valid, though their objects are perpetual. The number of persons employed by the British American Tobacco Co. Ltd. and associated companies exceeded 110,000.

The case foundered in the House of Lords on the rock entitled "public benefit" —"it is a clearly established principle of the law of charity that a trust is not charitable unless it is directed to the public benefit" (*per* Lord Simonds, at p. 33).

Thus a trust for ever for the education of the lawful descendants of three named persons was held invalid (no matter how numerous the class might become) because the introduction of named persons brought in a purely personal qualification (*Re Compton,* [1945] 1 All E.R. 198).

So, in the *Oppenheim Case,* the House of Lords held, by majority, that the common employment of the beneficiaries would prevent them from being a section of the community so as to afford the trust the necessary public character to render it charitable and, there being for this purpose no distinction between the employees and their children, the gift was void for perpetuity.

Lord MacDermott dissented. The conventional approach to educational trusts, he found, was one of degree. No definition of what constituted a sufficient section of the public existed, and the course of the dividing line between what was and was not a section of the community was unexplored. The large number here involved was not decisive, but could not be left out of account.

His Lordship then scathingly attacked the general application of the "Compton test" on three grounds:—

(1) The "difficulty in dividing the qualities or attributes which may serve to bind human beings into classes into two mutually exclusive groups, the one involving individual status and purely personal, the other disregarding such status and quite impersonal."

"If the bond between those employed by a particular railway is purely personal, why should the bond between those who are employed as railwaymen be so essentially different? Is a distinction to be drawn in this respect between those who are employed in a particular industry before it is nationalised and those who are employed therein after that process has been completed and one employer has taken the place of many? Are miners in the service of the National Coal Board now in one category and miners at a particular pit or of a particular district in another? Is the relationship between those in the service of the Crown to be distinguished from that obtaining between those in the service of some other employer? Or, if not, are the

Legal Section—continued

children of, say, soldiers or civil servants to be regarded as not constituting a sufficient section of the public to make a trust for their education charitable? It was conceded in the course of the argument that, had the present trust been framed so as to provide for the education of the children of those engaged in the tobacco industry in a named country or town, it would have been a good charitable disposition, and that even though the class to be benefited would have been appreciably smaller and no more important than is the class here. That concession follows from what the Court of Appeal has said. But if it is sound, and a personal or impersonal relationship remains the universal criterion, I think it shows, no less than the queries I have just raised in indicating some of the difficulties of the problem, that the 'Compton test' is a very arbitrary and artificial rule" (p. 41).

(2) The question of public benefit becomes of little moment.

(3) "The 'Compton test' is more likely to create confusion and doubt in the case of many trusts and institutions of a character whose legal standing as charities has never been in question.

"I have particularly in mind gifts for the education of certain special classes, such, for example, as the daughters of missionaries, the children of those professing a particular faith or accepted as ministers of a particular denomination, or those whose parents have sent them to a particular school for the earlier stages of their training. I cannot but think that in cases of this sort an analysis of the common quality binding the class to be benefited may reveal a relationship no less personal than that existing between an employer and those in his service. Take, for instance, a trust for the provision of university education for boys coming from a particular school. The common quality binding the members of that class seems to reside in the fact that their parents or guardians all contracted for their schooling with the same establishment or body. That the school in such a case may itself be a charitable foundation seems altogether beside the point and quite insufficient to hold the 'Compton test' at bay if it is well founded in law" (p. 42).

It is to be hoped that Lord MacDermott's dissent will reach legislative ears, for there can be no doubt that this branch of the law has become far removed from reality and is over-ripe for amendment.

WILLS: GIFT TO HOSPITAL — HOSPITAL "NATIONALISED" AFTER DEATH BUT BEFORE LEGACY PAID OVER

By his will, dated 4 July 1940, a testator, who died on 10 January 1948, directed his executor and trustee to divide his residuary estate into twenty-two equal units. The testator gave one such unit "to the trustees of the Ingham Infirmary and South Shields and Westoe Dispensary" in memory of his father. On 5 July 1948 the *National Health Service Act* 1946 came into force and the question arose in whom the right to receive the share of the testator's residuary estate was vested.

Held (Chancery Division, *per* Vaisey, J.): the testator's intention was to promote the carrying on the work of the institution and to commemorate his father, and, although the Act of 1946 had caused a fundamental change in the administration and ownership of the property of the institution, there was not such a difference that the object of the gift could be said to have failed, and the share must be paid to the appropriate management committee to be applied for the purposes of the institution. (*Hunter (Deceased), Lloyds Bank Ltd.* v. *The Mistress and Governors of Girton College, Cambridge, and Others,* [1951] 1 All E.R. 58.)

COMPANY LAW: REDUCTION OF CAPITAL NOT CONFIRMED ON GROUND TRANSACTION TO AVOID TAXATION

The paid-up capital of a company was £50,000 in £1 shares, of which 25,000 were ordinary shares and 25,000 "B" shares with restricted rights to dividends, all being held by two individuals.

On 3 November 1950, by means of a bonus issue out of reserves, each shareholder received one new share of the same class for every old share held, making the paid-up capital £100,000 in 50,000 ordinary

Legal Section—continued

shares and 50,000 "B" shares. On the same day, a special resolution was passed reducing the share capital to £25,000 by returning all the capital on the "B" shares and 10/- per share on the ordinaries.

Again on the same day, ordinary resolutions were passed, subject to the reduction of capital being confirmed by the Court: (a) consolidating the remaining 50,000 10/- shares into 25,000 £1 shares, and (b) restoring the authorized capital to £100,000.

When the petition for reduction came before the Court, it appeared that the company was solvent and had a large stock of second-hand cars which it proposed to reduce, as conditions in the market had altered, and the reduction was supported by the directors' views that the capital was in excess of the company's requirements.

Held, in the Scottish Court of Session (Inner House), the Lord President dissenting: that the reduction of capital should not be confirmed on the ground that it was a transaction to avoid taxation, and that in any event the financial position was such that the Court would have directed that the creditors should be given an opportunity under s. 67 (2) of the *Companies Act* 1948 to object to the proposed reduction.

Note: Under Commonwealth law, any bonus issue out of reserves comprised of trading profits is, in general, assessable, so that the procedure adopted in this case would not enable the shareholders to escape tax in Australia on the cash which they received. Even were the principles of *Blott's Case* still applicable in Australia, it is probable that the Commissioner of Taxation would attack a transaction such as the above as being an arrangement struck at by s. 260 of the Assessment Act.

Whilst a Court of Equity considering a scheme for reduction of capital is entitled to have regard to public policy, it is submitted that it cannot disregard the oft-established right of the subject to enter into such legal arrangements as he may choose to mitigate the incidence of taxation.

GARNISHEE: WHETHER JUDGMENT CREDITOR DEFEATED BY PRIOR ORDER BY JUDGMENT DEBTOR TO PAY THE DEBT TO A THIRD PARTY

The *Law of Property Act* 1925 (Eng.), s. 136 (1), provides that an assignment of a debt is valid when under the hand of the assignor accompanied by notice in writing to the debtor.

A was indebted to B, and B to C. C recovered judgment against B on 16 March 1950, and on 27 July served a garnishee summons on A, which resulted in a garnishee order being granted against A on 11 October 1950. Meanwhile, on 20 March 1950, B directed A to pay to a third party, D, all moneys payable to B under the contract between them. No notice to pay was given by D to A, but the direction from B to A referred to arrangements "for valuable consideration" made between B and D which implied that D had agreed to receive payment from A.

During the garnishee action in the county court, C contended that the direction by B of 20 March was not a legal assignment of the debt owing by A, as there was no evidence of D's having been aware of it, and it was merely an instruction to pay. The judge of first instance took the view that the document was executed with a view to defeating C's judgment and was not a valid assignment.

On appeal to the Court of Appeal the case was remitted to the county court judge to enable D to appear and state its claim.

The Court referred to the appellant's contentions that a transfer of property to a person without his knowledge, if made in proper form, may vest the property in him at once, subject to his right to repudiate it when informed of the transfer (*Standing* v. *Bowring* (1885), 31 Ch. D. 282), and that a direction in writing to a debtor by his creditor to pay a third party, handed to the third party, will suffice to effect a legal assignment on notice of such direction being given to the debtor (*Brice* v. *Bannister* (1878), 3 Q.B.D. 569; *Harding* v. *Harding* (1886), 17 Q.B.D. 442). Reference was also made to the contention for B that s. 136 (1) only applied when there was a document amounting to an absolute assignment and that the direction of 20 March was in form merely a direction and revocable. However, said the Court, fraud was not to be presumed without proof, and mere suspicion on one side was met with prima facie evidence of an assignment, either legal or equitable, on the other. (*Curran* v. *Newpark Cinemas Ltd. and Others*, [1951] 1 All E.R. 295.)

STUDENTS' SECTION

Edited by
K. C. KEOWN, A.I.C.A., A.M.T.C.

BUDGETS AND BUDGETARY CONTROL

by
F. H. WILLIAMS

PART II

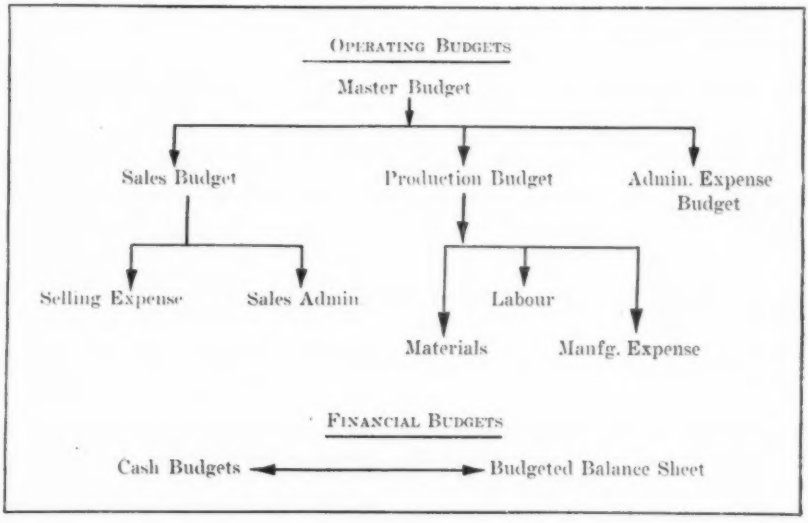
The Budgets

The budgetary system, particularly for a large manufacturing business, demands the preparation of several budgets or estimates. These may be classified into two main types—

(a) operating budgets,
(b) financial budgets.

The following chart illustrates how the various budgets fall under these two groups.

CHART 1



Operating Budgets

MASTER BUDGET.—A master budget may be defined as an estimated or budgeted operating statement, compiled prior to the commencement of operations, which combines the total figures of the subsidiary budgets. It has been previously stated that a business exists for the purpose of earning a profit—how this profit can be achieved is shown by the master budget.

Following this line of approach it becomes necessary to arrive at the desired profit figure. This, of course, will be de-

Students' Section—continued

cided after considering the various factors involved — such as the total capital invested, interest on borrowed capital, taxation provisions, dividends to shareholders, the creation of reserves for plant replacement and the extension of the business, etc.

It should also be borne in mind that, for a given period, it may be necessary to budget for a LOSS owing to an unavoidable set of circumstances or a major change in policy—as for example, where a number of new "lines" are to be introduced into a business already making losses or slender profits—considerable expenditure in "tooling up" may be necessary and therefore time is lost before the new products will be capable of earning a profit.

Chart No. 2 shows how the desired profit may be calculated.

PROFIT CALCULATION

Item	*Required £'s*
Preference Dividend, 7%	4,000
Ordinary Dividend, 5%	6,000
Reserves	3,500
Taxation Provision	6,500
Profit Required	£20,000

CHART 2

The required profit having been calculated, the process of co-ordination with the other activities of the business must now be given close attention. It may therefore be necessary to vary selling policies, institute more rigid control over expenses, take immediate steps to "boost" production, and generally to change policies governing the subsidiary estimates until the whole of the budgetary system is correctly co-ordinated.

The problem of the desired profit has been dealt with in some detail, as it is the opinion of the writer that every effort must be made to obtain that profit in order to preserve the financial stability of the concern and enable any programme for extension or rehabilitation to be successfully and readily carried out.

The master budget is illustrated in various forms by the many text-book writers. Chart No. 3 is a form of master budget for a manufacturing concern covering a period of twelve months, which would be broken down into monthly estimates for the purpose of short-term comparisons with actual results.

Students' Section—continued

MASTER BUDGET

for year ending June, 1980

Net Sales			£200,000
Less Cost of Sales:			
Stocks at Start—			
Raw Materials	£9,000		
Work in Process	5,000		
Finished Stocks	6,000		
Total Stock at Start	£20,000		
Add: Raw Material Purchases	71,000		
Direct Labour	43,000		
Manufacturing Expense	43,000		
	£177,000		
Less Stocks at End:			
Raw Materials	£8,000		
Work in Process	4,000		
Finished Stock	5,000		
Total Stock at End	17,000		
Cost of Sales			160,000
Estimated Gross Margin			£40,000
Less: Selling and Delivery Expenses	£12,000		
Administrative Expenses	8,000		
			20,000
Estimated Net Profit—before Taxation Provision, etc.			£20,000

CHART 3

Note re Work in Process: If detail is desired this item could be dissected thus—Material in Process, Labour in Process, Expense in Process.

SALES BUDGET.—The sales budget shows the estimates of the products to be sold during the budget period, and where these sales should be made. Therefore the sales manager should be able to furnish estimates based upon past results and adjusted to allow for the effect of existing and forecasted general business conditions

Students' Section—continued

in each of the various sales territories. Consideration would also be given to the advisability of additional territories and/or abandoning of existing ones. Thus having assessed the external conditions, he may be in a position to make recommendations as to internal policies, such as alterations, additions, or limitations to lines or products handled, increases or decreases in prices of existing lines, and prices at which new lines will be competitive. A sales budget is illustrated by Chart No. 4.

SALES BUDGET

for year ending 30th June, 1980

PRODUCT	TERRITORIES											
	No. 1		No. 2		No. 3		No. 4		Etc.		TOTAL	
	Qty.	£	Qty.	£	Qty.	£	Qty.	£			Qty.	£
A												
B												
C												
etc.												
TOTALS												
Cost of Sales												
Gross Margins												

CHART 4

NOTE: Cost of Sales and Gross Margins are included so that a check may be made to ensure the desired "mark up" for each territory.

SELLING EXPENSE BUDGET.—The sales manager, having compiled his sales estimates, should also consider his requirements of staff and facilities to implement the sales programme. These costs will then be the basis of the selling expense budget. The selling expense items may be divided into chargeable and non-chargeable items.

Students' Section—continued

Chargeable — those items directly chargeable to selling. Non-chargeable—items of a general nature, portion only of which will be borne by the selling department. This budget is illustrated in Chart No. 5—total of expenses only are shown, but it should be noted that the selling organization may consist of several departments.

SELLING EXPENSE BUDGET

for the year ending 30th June, 1980

ITEM	£	%
Sales Estimate	200,000	100.0
Chargeable Expenses—		
Salesmen's Salaries		
Salesmen's Commissions		
Advertising (Direct)		
Delivery Charges		
Etc.		
Total	15,000	7.5
Non-chargeable Expenses—		
Sales Office Expenses		
Advertising (Indirect)		
Etc.		
Total	5,000	2.5
Total Selling Expenses	£20,000	10.0

CHART 5

NOTE: Sales Administrative estimates are included above.

PRODUCTION BUDGET.—The estimate of production required during the budget period is prepared by the production manager. This plan aims at providing the finished products at the required times in order that the programme as set out in the sales budget may be realized. Factors to be carefully considered are estimated opening and closing stocks of finished products, economic stock levels during the period, plant facilities, etc.

PRODUCTION BUDGET

for the year ending 30th June, 1980

Item	Stock at End	Est. Sales	Total	Less Stock at Start	Est. Prodn.	COST OF PRODUCTION			
						Matl.	Labr.	Expse.	Total

CHART 6

Students' Section—continued

MATERIALS BUDGET. — The materials budget is a subsidiary of the production estimate, the purpose of which is to see that the necessary materials are available when required. Purchasing routines and the factors to be given attention are not set out here, as they are dealt with in detail in the various cost accounting text-books. However, the reader is reminded that due to various reasons, materials may be purchased, if obtainable, considerably in advance of production requirements, especially where delivery dates are uncertain, as is the case at present.

MATERIALS BUDGET

for year ending 30th June, 1980

No.	Kind	Max.	Min.	Stock at End	Est. Prodn.	Total	Stock at Start	To be Purchased	Notes

CHART 7

LABOUR BUDGET.—This budget indicates the estimated personnel requirements and cost for the period concerned. It is the personnel plan and, providing that the employment pool is available, may assist the management to acquire the number of employees of the desired type and so enable production to proceed as planned. Chart No. 8 is a simplified illustration of this type of budget.

LABOUR BUDGET

for year ending 30th June, 1980

Kind of Work	Wage Rate			July		August		Etc.	Total Cost
	1	2	3	No.	Cost	No.	Cost		

CHART 8

NOTE: Wage Rate columns 2 and 3 are for rate revisions.

Students' Section—continued

MANUFACTURING EXPENSE BUDGET.—The main purpose of this budget is to enable strict control over the expenses which are to be incorporated in the cost of production for the period, but it is, of course, also the basis for the calculation of the expense rate—full descriptions of how it is compiled are given in cost accounting studies, usually under the heading "Accounting for Expense."

MANUFACTURING EXPENSE BUDGET
for year ending 30th June, 1980

ITEM	BUDGET	ACTUAL	VARIATION	
			Loss	Gain
Fixed Expenses:				
Rent				
Insurance				
Depreciation (Plant) ..				
Etc.				
Variable Expenses:				
Non-chargeable Labour..				
Supplies				
Power				
Light				
Supervision				
Etc.				
Totals				

CHART 9

NOTE: Provision may also be made to show the expense absorbed in production and the resultant variation.

ADMINISTRATIVE EXPENSE BUDGET.—This budget is usually quite readily prepared by the accountant or secretary, and, where the concern is small, it is often included with the selling and delivery expense budget.

ADMINISTRATIVE EXPENSE BUDGET
for year ending 30th June, 1980

Item	£	%
Sales Estimate		100
Administrative Expenses—		
Administrative Office Salaries		
Managerial Salaries		
Directors' Fees		
Telephones		
Etc.		
Total		

CHART 10

BOOK REVIEWS

Advertising Administration (Lane's), Second Edition: N. T. SANDBROOK; Butterworth & Co. (Publishers) Ltd., London, 1951. Pp. 242, price £A1/1/-.

The first edition of *Advertising Administration (Principles & Practice)*, by F. B. Lane, was No. 1 in Butterworth's "Library of Advertising" comprising nine volumes published in 1931. The titles of the other volumes are *Market Research, Advertising Media, English for Advertising & Commerce, Psychology & Advertising, Applied Psychology for Advertisers, Lay-out & Commercial Art, Printing, Reproductive Means & Materials, Direct Mail & Mail-Order.* Two further books on advertising have been published by Butterworths recently, viz.: *Guide to Advertising Studies* (1949) and *The Law of Advertising* (1950).

Each book in the "Library of Advertising" is self-contained, but its value cannot be fully appreciated unless it is read together with the companion volumes in the series. Collectively, the "Library" covers the advertising field comprehensively. The authors who contributed to the series were all recognized authorities in their respective subjects. The "Library" is practical and not academic.

Advertising Administration was originally written for the student of advertising. It has now been extensively revised and brought up to date, but the general arrangement of the previous edition has been preserved. The book is intended to serve as an introduction to and a general survey of the profession and its various sections and their methods of working.

The book is divided into four parts.

In Part I, the advertising business and its method of working are explained, the economic utility of advertising is discussed, the different types of advertising are described, the assessment and allocation of the advertising appropriation are dealt with, advertising media are surveyed, some of the most important organizations in the advertising field (England) are reviewed, and finally the legal aspects of advertising are considered.

Part II deals with the duties of the advertising manager, his relationship to the sales manager and with the publisher, the recording of space purchased, the analysis of expenditure and results, and the relationship of the advertiser with the agency.

Part III relates to the functions of the agency, how it works, and the relationship between it and the publisher.

Part IV concerns the advertisement department of the publisher, the selling of space and space filling, and concludes with a general survey of the relationship between the advertisement department, the agency, and the advertiser.

In the preface to this book the author states that its purpose is "to outline the structure of the advertising profession." This purpose has been achieved in an able, lucid, and practical manner. The book is well written and is easily readable. It fully justifies its place as a textbook on advertising administration.

A.G.W.

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End Pages

by

Angus Lancaster

Publishers and Authors

There is a delightful article in the August 12, 1950, issue of *.Publishers' Weekly* (the American book trade journal) by Doris Schneider, "Why Authors Leave Home." The article discusses the problem of making authors secure and happy enough in their dealings with publishers so that they stay at home (with the publishers).

From the author's viewpoint I cannot but despise a man who repeatedly changes his publishers. One of the worst examples was H. G. Wells. I never look along my long row of his books without the same feeling of disgust at the many times he "left home."

But Wells is an exception. If you glance down your books you will find that most authors stay at home. A shining example is Aldous Huxley, who has always stayed in the home of Chatto and Windus.

Doris Schneider concludes her article by saying: "Truly we live in what Auden has called the Age of Anxiety, and publishers have their share of trouble. But the creative artist is always closer to fear, more vulnerable, more easily disturbed in his creative function. It is the highest responsibility of publishers, together and separately, to behave in such fashion as to give their authors the greatest amount of security possible." The author rightly claims that the quality of integrity is essential, above all qualities and attainments, in creating that sense of security.

How glad I am to testify to this claim. I have written books for the publishers of this journal for many years, during which they have paid me thousands of pounds. The money has gone; the friendship remains. At odd times they make me very angry, although I am one of those tolerant persons who doesn't care a fig what the publisher does so long as it is perfect. But I have known no fear for I have complete confidence in their abiding fairness and integrity.

Among the gems in Doris Schneider's article is: "Some people forget the lovely adage that people who live in glass houses should undress in the dark."

The Joys of Public Practice

Our firm recently advertised for a junior clerk. We got one reply. The youth said that he would join us "provided he had no auditing work to do."

I wonder how the other professions are faring. Are lawyer's articled clerks stipulating "No conveyancing"? Does the dentist's apprentice bar "fang-snatching"? And what of the medical students? Will there soon be a strike against cirrhosis patients?

The present days all seem like cirrhosis to me.

Incantevole

A reader has asked the meaning of the above word (pronounced: incan*tay*volay) which appeared in a certain scabrous tax book. The English rendering of this Italian word is "enchanting," "charming."

The Italian noun "incanto," meaning "enchantment" or "charm," also stands for a public sale or auction. For example, "vendere all incanto" means to sell by auction. I do not know why it has this derived meaning, but I presume it has something to do with the charm exercised by the auctioneer in the course of beguiling the bidders.

As Oscar Wilde put it: "It is only an auctioneer who can equally and impartially admire all schools of art."